



Foreign Agricultural Service

GAIN Report

Global Agriculture Information Network

Scheduled Report - public distribution

Date: 11/15/1999

GAIN Report #CH9835

China, Peoples Republic of

Retail Sector Report for East and North China

1999

Prepared by:

LaVerne E. Brabant

U.S. Consulate General, Shanghai

Drafted by:

Wade Sheppard

Report Highlights:

Explosive growth in the retail sector, brought on by a booming economy, rising consumer incomes, and policies favoring development, have changed the face of Chinese retail in the last decade. Moribund state-run stores are learning to compete with foreign-managed operations by improving management, merchandising, selection, service, and price. China's likely accession to WTO should create even greater export opportunities, although China will remain a challenging market.

Includes PSD changes: No

Includes Trade Matrix: No

Annual Report

Shanghai ATO [CH2], CH

TABLE OF CONTENTS

Section I. MARKET SUMMARY Page 2 of 9

Section II. ROAD MAP FOR MARKET ENTRY Page 3 of 9

A. Supermarkets, Hypermarkets, Clubs and Warehouse Stores Page 3 of 9

B. Convenience Stores, Gas Marts, Kiosks Page 5 of 9

C. Traditional Markets, Foodstuff Stores, and “Mom and Pop” Stores Page 6 of 9

Section III. COMPETITION Page 6 of 9

Section IV. BEST PRODUCT PROSPECTS Page 7 of 9

Section V. POST CONTACT AND FURTHER INFORMATION Page 7 of 9

Section I. MARKET SUMMARY

- Growth is skyrocketing in China's food retail sector despite the slowdown in other sectors. In Shanghai alone, retail food sales exceeded 60 billion Yuan (US\$7.2 billion) in 1998, up 13.5% over 1997 (source: Shanghai Commerce Commission).
- US high value products with good prospects in China include: poultry, red meat, fresh fruit, pork offal, tree nuts, dairy products, frozen ready made foods such as dumplings, and ginseng.
- China's chain supermarket sector is developing rapidly, with Shanghai currently in the lead and Guangzhou and Beijing catching up rapidly. Shanghai has more than 1200 supermarkets and approximately 20 hypermarkets, all in a sector that did not even exist a decade ago. However, competition is fierce and many chains claim operating losses.
- Shanghai leads the nation in the purchase of frozen and chilled food products, and demand nationwide is growing rapidly. China's frozen dumpling market alone had an estimated value of \$300-400 million in 1998 (source: Shanghai Commerce Commission.)
- Most domestic chain stores have not yet expanded outside their city of origin, and China's distribution system is highly fragmented and inefficient. The cold chain is largely non-existent outside major port areas. Market development must be approached on a regional or city basis.
- High tariffs and other barriers to entry have prevented many US products from entering China, but China's likely entry into WTO will reduce barriers and improve prospects for many product categories.
- Imported food generally has a less than 5% share of retail shelf space, although the percentage tends to be much higher for convenience stores. Most retail stores lack import rights and therefore source locally, so imported food content will generally stay low in the medium term.
- The success of foreign-invested hypermarkets such as Carrefour is forcing supermarkets to reduce prices and consolidate or enlarge store space to remain competitive. Carrefour's combination of the right product mix of mostly local products, format, good partners and strong management have made it one of the few financially successful chains in China.
- Recent regulatory changes mean foreign retailers should be able to increase equity and expand more rapidly than in the past. However, central government protection of local operators has traditionally weakened the competitiveness of foreign operators, so it is too early to tell what the outcome of the new regulations will be.

Advantages and Challenges facing US Products in China	
Opportunities	Constraints
American Products are considered as high quality by Chinese consumers	There is generally little awareness of American products or brands among Chinese consumers
Major urban centers (Shanghai, Beijing) have sizable populations of high income consumers	The average income of local consumers is much lower than in the west
Customs enforcement of tariff payments and quarantine restrictions is generally lax	China maintains high tariffs on most high value consumer foods and beverages
The superior packaging of western products gives the impression of better quality	Domestic manufacturers are rapidly improving their product quality and packaging standards

Great interest in American products on the part of both local distributors and consumers	Distribution tends to be relationship-driven rather than based on western business practices
Chinese traders are generally conscientious about maintaining good relations with overseas suppliers	Chinese traders are often ignorant about international trade and finance methods

Section II. ROAD MAP FOR MARKET ENTRY

A. Supermarkets, Hypermarkets, Clubs and Warehouse Stores

Entry Strategy

- Focus on the “Big Three.” Beijing, Shanghai and Guangzhou are China’s most developed markets and the primary destination for most imported food products. It is generally not worth investigating other cities in China until you have established a “beachhead” in at least one of these cities.
- Recruit a local distributor. Most retailers lack importation rights or access to credit and only purchase imported food and beverage products (for cash) from local distributors or wholesalers. Many distributors who handle imports and have national reach are located in Guangdong province. The most effective recruitment methods are:
 - 1) Exhibit at local trade shows. Due to the difficulties in obtaining a U.S. visa, many distributors confine their import buying to overseas companies that visit and learn about the local market.
 - 2) Work with the local state and regional trade offices, market development cooperators, and U.S. Agricultural Trade Offices (USATO) in Guangzhou and Shanghai. The ATOs hold regular promotional activities that may provide opportunities to meet the Chinese trade.
- Invest in promotion. Many supermarket and hypermarket managers in China feel that imported food and beverage products could be more popular in their stores if the manufacturers and distributors would spend more resources on advertising and promotion in order to enhance consumer knowledge. Many of these same managers believe television is the best way to increase consumer knowledge, though an expensive proposition. However, joint venture managers state that Point of Purchase (POP) materials and sampling are more effective in growing sales.

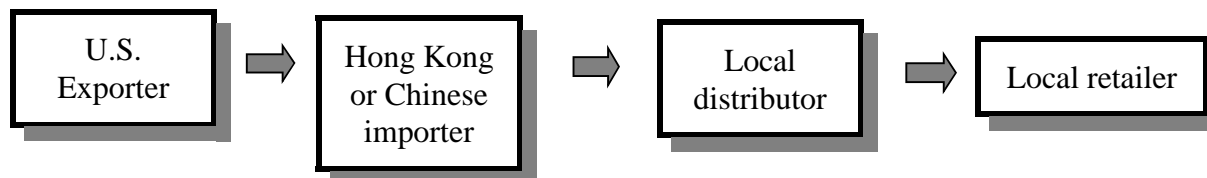
Distribution Channels

- China’s distribution system is complex and very chaotic, especially in southern China where most imported products enter the market and where grey channel activity is rampant.
- Retailers rarely purchase imports directly from overseas suppliers, as it is uncommon for retailers to have import rights. The few exceptions are generally privately-owned companies catering to expatriate consumers or niche markets.
- The unofficial renting, selling, and trading of import rights has made it easy for many local companies to become imported product distributors. Yet at the same time, this system makes it difficult to assess whether a potential distributor would make a viable partner.
- Many distributors in South China rely on Hong Kong companies to be their supplier and financier of imported food and beverage products. Some stores reportedly send trucks to Hong Kong to purchase

foreign products they wish to carry in their stores from Hong Kong discount hypermarkets.

- A recent crackdown on the grey channel in South China has brought more trade to ports such as Shanghai and encouraged more trade into official channels. However, it is unclear what impact this will have on long-term trade patterns.
- Although slotting fees (charging for shelf space) are not universally applied, many retailers require special fees for getting good shelf space, in-store advertising, and other services.

Chart: Distribution Flow of Food Products into China



Company Profiles: Selected Supermarkets and Hypermarkets in North and East China				
Retailer name and outlet type	Ownership	Jan-May 1999 Sales (RMB) (Shanghai only)	Number of outlets nationwide (July, 1999)	Location (City)
Carrefour, Hyper	Sino-French	75,987,000	14+	Shanghai(4), Beijing, Tianjin
Auchon, Hyper	Sino-French	(newly opened)	1	Shanghai
Lotus, Hyper	Sino-Thai	58,443,000	3	Beijing, Shanghai
Metro, Club/Warehouse	Sino-German	123,036,000	5	Shanghai(3), Hangzhou, Nanjing (Fall '99)
Trust Mart, Hyper	Taiwan	N/A	6	Beijing
Ahold Tops, supermarket	Sino-Dutch	19,248,000	39- (leaving market)	Shanghai
Wal-mart, hyper	US	N/A	5	Beijing
CRC, supermarket	Chinese	N/A	21	Shanghai
Lianhua, supermarket	Chinese	172,002,000	343	Shanghai
Park'N Shop, supermarket	Hong Kong	N/A	50 +/- (undergoing consolidation)	Shanghai (20+/-), Beijing

Hualian, supermarket	Chinese	102,776,000	312	Shanghai
-------------------------	---------	-------------	-----	----------

(Shanghai TRINDE Consulting, July 1999)

Product purchasing managers usually do not actively solicit new products, but wait for manufacturers and distributors to come to them. However, retailers are often open-minded about trying out new products, allowing trial sales periods of one to four months before making a final decision. In these cases, the product sales need to be above average in comparison with similar products in order to remain on the shelves. Seasonality is usually taken into account. Generous payment of fees can extend shelf lives for products too. Limited private labeling occurs in a few chains.

Supermarkets and hypermarkets require credit when purchasing most products. The re-payment period varies from chain to chain and from product to product. The current range averages between 60 and 90 days, but some chains delay this period even further. Some chains seem to delay payment in order to provide short term capital to finance their stores, in effect using the sales revenues as a 'not-so-short-term' loan. The average repayment period has become longer in recent years and in turn has caused some distributors to cease distribution to certain supermarkets and hypermarkets.

A few chains and specialty stores catering to the expatriate market in Shanghai are beginning to experiment with home delivery and use telephone or internet ordering. We expect to see these services become more common but not mainstream over the next several years as chains use service and convenience to distinguish themselves in this highly competitive market.

Hypermarkets have been phenomenally successful in China over the last two years. There have been frequent stories in Beijing, Shanghai and other cities of thousands of would-be customers swamping new stores on opening day just to wander the store and gawk at the merchandise. The Chinese government has taken notice, and several locally-managed stores of a similar format have opened in the past year to a slightly less enthusiastic response. This sector is expected to see the most growth over the next few years, and likely will continue to force the smaller, state-run stores to compete or consolidate.

B. Convenience Stores, Gas Marts, Kiosks

Market Structure

Convenience stores are a relatively new but highly successful concept in China. To date, only a couple of the overseas chains such as 7-11, Lawson and am-pm have established themselves in China, although there are many Hong Kong managed chains, such as Kedi and Basics, as well. In addition, some gas stations are adding mini-marts, although most of China's cars are fleet-operated and make limited use of public gas stations. The main competition for convenience stores is the thousands of kiosks (small shops or even stands which are basically scaled-down independent convenience stores) that dot the cities, and not supermarkets and hypermarkets. As a matter of fact, they see their roles as complementary. One convenience chain executive claims that locating near a hypermarket is good for them, because these large stores tend to generate more business, through increased area foot traffic, than they take away. In the Shanghai area alone, there are currently 21 (mainly local) major chains operating more than 1,000 convenience stores, accounting for US\$206 million in retail sales turnover in 1998 (Source: Shanghai Commerce Commission).

Market entry and distribution methodologies for these types of stores are generally the same as for supermarkets and hypermarkets, although some chains purchase from wholesalers. In fact, many of the Shanghai-based convenience store chains are part of the same conglomerates as their supermarket cousins and share the same distribution network. They mainly stock imported candy, snacks, alcohol, and cigarettes. Convenience stores earn sizable revenues from prepared foods such as hot dogs, dim sum and corn-on-the cob. The overseas invested convenience store chains usually buy products on short-term credit, one month or less, while kiosks often pay cash. Both convenience stores and kiosks generally sell the same types of food products, with the exception that convenience stores tend to specialize in prepared food items but no fresh fruit while some kiosks specialize in only fresh fruit. The state-run convenience stores are expanding rapidly, but have only recently begun to develop their product selection and merchandising to match foreign-managed competitors.

Company Profiles: Convenience Stores in Shanghai		
Retailer	Ownership	No. of Outlets
Lianhua	Chinese	98
Liangyou	Chinese	84
Lawson(Hualian)	Sino-Japanese	50
Basics	Hong Kong	60+
Kedi	Hong Kong(Dairy Farm)	100+

C. Traditional Markets, Foodstuff Stores, and “Mom and Pop” Stores

Market Structure

These types of stores and markets are still popular among the local consumers, although the government is promoting a move away from them in favor of chain stores. Wet markets, for example, remain the main source of meat and produce, as they are still generally viewed as a cheaper and fresher source than supermarkets. Some imported products such as fruit and snack foods find their way into these places, but by the time they reach this level all knowledge of their origin is usually lost. It has been reported as well that some joint venture meat processors are attempting to sell excess capacity in the wet markets until demand for their higher-end products can develop. Outside of major cities, chain store development is non-existent, and nearly all fresh food is purchased in wet markets.

Traditional “Foodstuff” stores are struggling against stiff competition from the chain stores, but they remain a viable market for tinned foods, health products, and snack foods and other dry goods. In time, they will likely continue to evolve in the direction of chain stores until they become virtually indistinguishable. Many of the foodstuff stores are owned by the same conglomerates which manage some state-run retail chains, so they will have a common distribution network and access to many of the same products.

Section III. COMPETITION

- US exports to China of high value consumer food and beverage products totaled \$843 million in 1998.

Approximately 84% of the total entered Hong Kong before re-export to China.

- US origin food products are highly regarded by Chinese consumers, but are not always regarded as the highest quality in their category. For instance, French wine, Australian and New Zealand dairy products, and Norwegian Salmon are more highly prized than their American counterparts.
- China's food and beverage industry is fairly developed, and there are many joint venture competitors with local manufacturing plants which compete favorably against imports. Also, domestic competitors are quick to innovate and often emulate successful imported or joint venture products.
- Many countries other than the United States have trade promotion offices in China, and a great emphasis is placed on competing directly with American products. Furthermore, countries with a greater proximity to China such as Australia and New Zealand have a competitive advantage with beef, dairy products, wine and certain seafood such as lobster.

Section IV. BEST PRODUCT PROSPECTS

Products in the market with good prospects:

- Fruit such as table grapes, Washington apples, and cherries
- Snack foods, especially nuts and dried fruits
- Cookies and bakery items/ingredients
- Candy/chocolate: one American-made brand of chocolate is currently in the Shanghai top five, despite being much pricier than its domestic and joint-venture competitors
- Frozen french fries (US is China's largest supplier)
- Milk powder, whey powder, infant formula
- Corn, frozen or canned (kernel or on the cob)

Products not present in significant quantity but which have good potential:

- Baby foods, particularly those made from fruits and vegetables
- Premium ice cream: there is a small market at present, but long-term potential looks good
- Citrus (pending implementation of agreement allowing direct imports of American citrus)
- Poultry and beef (especially chicken feet, beef stomachs, etc.)
- Frozen ready-made foods such as dumplings

Products which are present but which have poor sales potential:

- Beer: domestic production over-capacity has killed margins, and high import duties make imported beer prohibitively expensive except for niche markets like expatriate bars
- Wine: China's once promising wine market is still in its infancy and there is limited growth potential in the short term. Domestic competitors sell for less than half the price of the cheapest imports. Current U.S. market share is about 2%, yet prospects are more favorable 5-10 years down the road.
- Rice: China strictly controls the import of rice as it encourages self-sufficiency for domestic producers. Only a limited amount of high-end (i.e. non-competitive) foreign rice is found in local markets, especially those catering to expatriate and upscale consumers.

Section V. POST CONTACT AND FURTHER INFORMATION

Shanghai U.S. Agricultural Trade Office

Director: LaVerne E. Brabant

Shanghai Centre, Suite 331
1376 Nanjing Xi Lu
Shanghai 200040, People's Republic of China
Tel: (86-21) 6279-8622
Fax: (86-21) 6279-8336
Email: atos@public.sta.net.cn
Internet: <http://www.atoshanghai.org>

For further information about exporting to China, upcoming events and activities, please visit the ATO Shanghai web page (www.atoshanghai.org). Among the many reports available on the ATO Shanghai web site are two that are recommended for first-time exporters to China: **Exporter Guide, China** (CH9830) and **Business Travel in China** (CH9818). Reports from ATO Shanghai and other ATO offices around the world are also available from the FAS web site (www.fas.usda.gov).